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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 003395

SIPDIS

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TAGS: EPET ENRG ECON PREL UP RS

SUBJECT: ANNUAL GAS ROW WITH UKRAINE HEATS UP

REF: A. MOSCOW 976

1B. MOSCOW 722

1C. MOSCOW 715

Classified By: Ambassador John R. Beyrle for Reasons 1.4 (b/d)

SUMMARY

11. (C) Gazprom's Director of Foreign Relations, Ivan Zolotov, told us November 24 that, despite press reports, there is "no serious discrepancy" between Russia and Ukraine on the amount of the outstanding gas debt, which he claimed is approaching \$3 billion. He said negotiations to resolve debt repayment and to finalize a new contract for 2009 (and perhaps beyond) are on-going, but that Gazprom is firm that an agreement on debt payments must be made before a new contract is signed. Ukrainian embassy contacts suggested a new contract may be signed as early as this week, but provided no details. As a major hiccup in gas deliveries to Ukraine would serve neither side's interests, we believe some agreement will be reached to avoid such a situation. End summary.

ANNUAL RITUAL HEATS UP

12. (U) The annual gas price negotiations with Ukraine hit the headlines on November 21, with reports that President Medvedev has demanded that Gazprom collect a claimed \$2.4 billion in gas payment debts from Ukraine. Gazprom CEO Alexey Miller reportedly followed up by threatening Ukraine with having to pay \$400 per thousand cubic meters (mcm) of gas in 2009, up from \$179.50 in 2008, if the debt was not paid. Gazprom's spokesman said the two sides had previously agreed that Ukraine would pay "market prices" by 2011, with increased but still subsidized prices in 2009 and 2010. The spokesman said, however, that Gazprom would not abide by that agreement if Ukraine did not pay off its debts.

13. (SBU) Various press stories have the two sides disputing the amount of the debt, although ITAR-TASS, citing Ukrainian press, reported November 24 that the Ukrainian gas company, NaftoHaz, had accepted a figure of \$2.25 billion. NaftoHaz had previously claimed the sum was \$1.27 billion and owed to RosUkrEnergo -- the murky intermediary that is 50% owned by Gazprom and 50% owned by Ukrainian businessmen Dmitri Firtash and Ivan Fursin (ref B).

14. (C) Ivan Zolotov, Gazprom's Director of Foreign Relations, told us November 24 that the debt will "approach \$3 billion" by the end of the year and added that "there is no serious

discrepancy" on the amount, despite press reports to the contrary. He claimed Ukraine is simply having difficulty paying due to the economic crisis and can't come to a single position in the negotiations due to domestic (Ukrainian) political posturing.

¶ 15. (C) Zolotov volunteered that much of the public rhetoric was part of Gazprom's "negotiating tactics," and reiterated Gazprom's long-standing claim that the gas trade with Ukraine is a "purely commercial matter." He said Gazprom's position is firm that the debt must be paid, or that payment terms must be agreed to, before a new contract for future deliveries is signed. Zolotov indicated Gazprom is "pushing even harder this year" because of the financial crisis and Gazprom's (and Russia's) need for cash. He also said Gazprom has "grave doubts" about Ukraine's ability to pay in 2009, given the economic crisis there.

RESOLUTION SOON?

¶ 16. (C) Zolotov said that although he has not yet made firm plans for the New Year's holidays (indicating he may have to be at work due to the dispute), he hopes the situation with Ukraine will be resolved soon. According to Zolotov, the ball is in Ukraine's court. Gazprom favors a long-term contract with no intermediaries and has been clear on this point with the Ukrainians. As for gas prices for 2009 and beyond, Zolotov said Miller's \$400 figure is likely correct for the first quarter, but that prices would fall beginning in the second quarter, in line with the six-month lag in gas

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prices relative to oil prices.

¶ 17. (C) The Ukrainian Embassy provided us with few details, saying only that negotiations were ongoing and that they expected a contract to be signed soon. Ukrainian Embassy Economic Counselor Svetlana Kuliy told us November 24 that Ukrainian negotiators were hopeful that a contract might be signed as early as the end of this week. Oleg Gutsulyak, head of the Ukrainian Trade and Economic Mission, told us November 24 that he expects the situation to be resolved soon as "winter is at our door."

COMMENT

¶ 18. (C) This annual winter ritual between Russia and Ukraine will, as always, get resolved eventually. However, it is further complicated this year by the global economic downturn. Russia's ultimate recourse, to cut off gas supplies, will be harder than ever to enact given that Ukraine is still its main transit route and Russia needs the cash from its gas sales -- not to mention the damage to Russia's reputation in Europe, only now starting to recover from the Georgia crisis, if gas deliveries are again disrupted. It may look different from Kyiv, but we suspect it will prove very hard for Russia to extract a high price from Ukraine with global demand dropping rapidly. Gazprom may need to be flexible with respect to payment of the outstanding debt -- as the Russian version of the proverb goes, you can't get blood out of a stone. End comment.

BEYRLE